The University of North Carolina at Chapel Hill

Company Transitions: Do Small and Family-Held North Carolina Businesses Need Succession Assistance?

Masters Project for the Department of City and Regional Planning

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Chapter 1: Why Small? Small Business Benefits to North Carolina's Economy.

Small Business plays a vital role in the American economy. According to the Small Business Administration, small businesses, defined as businesses with less than 500 employees, "…account for 50 percent of the country's private nonfarm gross national product, create between 60 and 80 percent of the net new jobs and are 13 to 14 times more innovative per employee as large firms are"[1]. Many, though not all, of these businesses are family owned or owner-operated. Small and family-owned businesses take many different forms; they can be high-growth startups at an early stage in the business lifecycle, lifestyle businesses, businesses that provide niche services or products, or true institutions that span multiple generations, woven into the very fabric of a community.

Although North Carolina is home to many multi-national companies such as Bank of America, Wachovia, and Lowe's Home Improvement, the state economy maintains a strong dependence on small business. The vast majority of the state is rural. Fifteen counties do not contain a firm with more than 500 employees, and the school district and/or local government account for all firms above 500 employees in thirteen other counties.[2] In these areas, small businesses provide critical services and sources of employment. In addition, as North Carolina contains industry clusters of biotechnology, agrotechnology, advanced manufacturing and military procurement, innovation is critical to North Carolina's future economic success. The creativity and startup potential of small and family-owned businesses drive this innovation in many cases. Finally, the state relies heavily on tourism, and small businesses provide the services, character, and charm necessary to attract visitors to tourist areas.

Small businesses provide North Carolina three specific economic benefits: providing jobs for a large percentage of the labor force, providing potential career ladders to those employees, and fostering

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[1] Small Business Administration. "Office of Advocacy Mission Statement" Accessed 12/5/2007 at: http://www.sba.gov/ADVO/mission.html

[2] Employment Security Commission of North Carolina, Labor Market Information Division. Top 25 Employers by County Based on September 2006 Employment. Accessed 2/19/2008 at http://jobs.esc.state.nc.us/lmi/largest/largest.pdf

innovation. Despite this there is often significant controversy and misinformation about whether to allocate funding and assistance to attracting new, usually large, businesses or sustaining existing firms of all sizes[3]. While larger businesses undoubtedly provide economic growth and benefits, focusing only on one segment of the business spectrum inhibits important economic diversification. Further investigation into the magnitude and impact of small business in North Carolina benefits can help determine if greater policy assistance in these areas would be of benefit to the state's economy.

Employment Benefits

Small business undoubtedly employs a significant percentage of the American labor force, as 57% of US

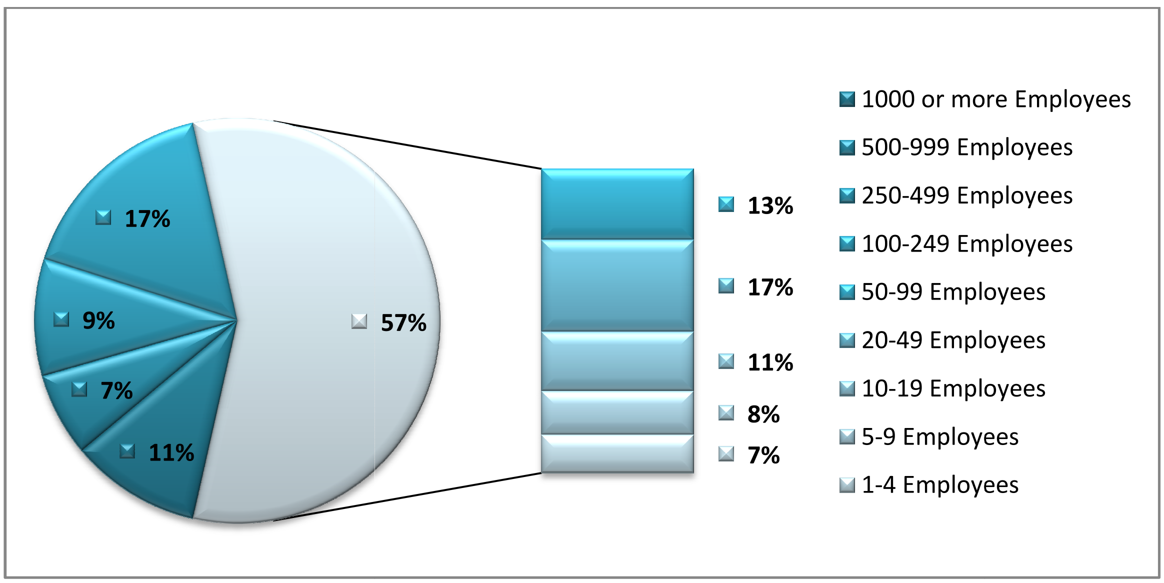

Figure 1: 2006 US Employment by Firm Size (1st Quarter Average)[1]

employment is concentrated in firms of 100 employees or less. Of this 57%, the largest portion is the 17% of employees that work in firms with between 20-49 employees. Seven percent of the US employed

[3] The Corporation for Enterprise Development. North Carolina Toolkit: "State Incentives to Lure Business and Create Jobs: Myths vs. Realities". Accessed 4/11/08 at http://www.cfed.org/imageManager/_documents/NC_Toolkit_-_Myths_vs_Realities.pdf

population works in establishments of 1-4 employees, but it is difficult to determine what percentage of these are single-worker establishments, especially as sole proprietorships are not included in these data.

In North Carolina, this concentration is even more exaggerated. Sixty percent of North Carolina's employed labor force works in businesses with 100 or fewer employees, and 19% of employees work in firms with employment of 20-49 employees. North Carolina also has distinctly fewer employees working in establishments with 1000 or more employees. 11% of US employees work in establishments

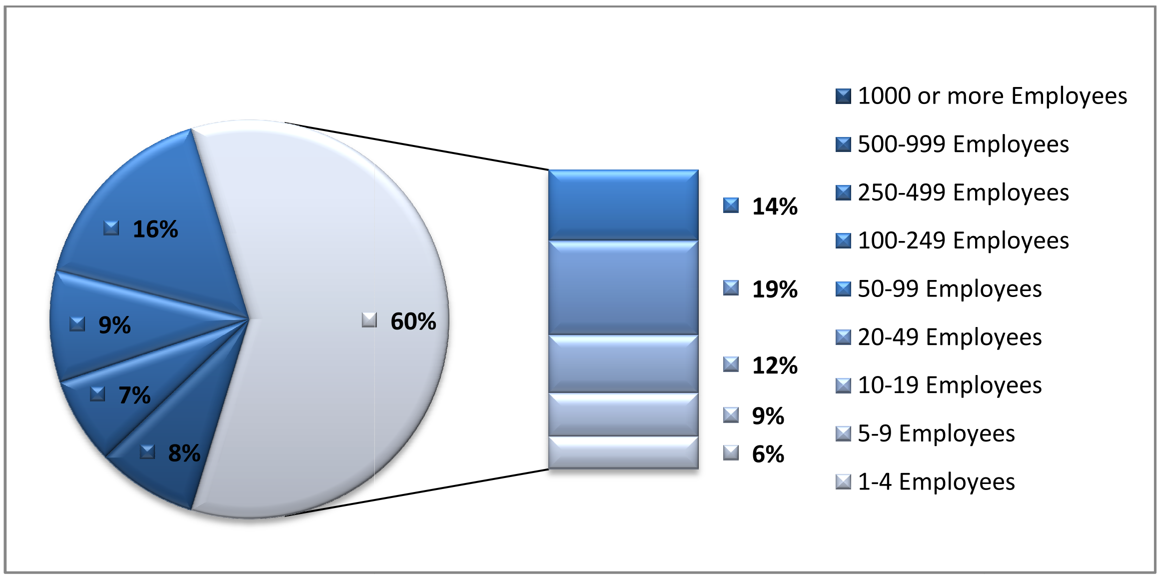

Figure 2: 2006 NC Employment by Firm Size (1st Quarter Average)[4]

of 1000 or more employees, while only 8% of North Carolina employees do. This may reflect the rural nature of many North Carolina counties, or it may be a kind of proxy for the recent loss of manufacturing jobs throughout the state. Nonetheless, changes in the small business climate are likely to affect North Carolinians more than the general population of the United States.

The growth of the number of employees in small businesses over the last few years in North Carolina begins to suggest a growing concentration of employees in smaller establishments. From 2005-2006,

[4] U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages. Average of Jan, Feb, Mar. employment. Accessed 11/21/2007 at http://www.bls.gov/data/home.htm

the number of employees working in establishments of 20-50 employees increased from 516,213 employees to 603,302 employees, making this the category that employs the most people in North Carolina. In the United States, most employees work in establishments of 100-249 people. At the same time, the number of North Carolina employees working in establishments of 100-249 employees and 250-499 employees declined significantly. The overall data indicate a concentration of employees in the 5-9 employees/establishment to 20-49 employees/establishment categories, particularly in the past year. The concentration and especially the growth of employees working in small businesses in North Carolina imply that the health of small business is crucial to the health of North Carolina's labor force.

Although initial research did (and does) show that small business creates many jobs, there is evidence that *net* job creation is influenced by other forces. At first, theorists asserted that large businesses were actually creating more jobs than smaller ones. According to these studies, the business size with the greatest net job creation was between 100-499 employees[5]. Smaller firms create jobs quickly but also lose them quickly, where as larger firms create fewer jobs but less frequently eliminate jobs. As firms with 100-499 employees are still within the category of "small business" as it is currently defined, this finding may be cause for a tighter focus on "medium-sized" businesses, but it does not rule out small business as a job generator altogether. Another remarkable finding of these studies, however, is the conclusion that firm age is highly responsible for job creation[6]. In David Evans' study of 100 manufacturing industries, "The results show that the probability of [job] survival increases with size and age. At the sample mean…. a 1 percent change in age leads to a 13 percent change in the probability of survival."[7] This is due to the fact that job destruction and employment volatility tend to decline with

[5] Davis, Steven, Haltiwanger, John, and Schuh, Scott. *Job Creation and Destruction.* The MIT Press, Cambridget, MA, 1996, p 62.
[66] Haltiwanger, John and Krizan, C.J. "Small Business and Job Creation in the United States: The Role of New and Young Businesses". In Ãcs, Z. J. *Are small firms important? :Their role and impact*. Klewer Academic, Boston, 1999. p. 94
[7] Evans, David. "The Relationship Between Firm Growth, Size, and Age: Estimates for 100 Manufacturing Industries". *Journal of Industrial Economics,* Volume 35, no. 4. June 1987, p 574. Accessed 1/17/2008 at http://links.jstor.org/sici?sici=0022-1821%28198706%2935%3A4%3C567%3ATRBFGS%3E2.0.CO%3B2-L

firm age[8]. This makes sense, as older firms, as long as they manage to compete within their industries, would have a greater stability than newer firms just by means of knowledge and experience. Perhaps more importantly, firm age has also been shown to have an impact on employee wages: "One of the most striking results….is the positive impact of firm age on productivity and employee compensation, even after controlling for the size of a firm"[9]. This implies that increasing the lifespan of firms is beneficial for both job creation and wage increases.

Opportunity Benefits

Small business proponents argue that small businesses provide a crucial mechanism for individuals to enter into the labor force. Because small businesses might take intangible or social factors into greater account than large businesses when making hiring decisions, some theorists posit that small firms provide up to two-thirds of initial job opportunities[10]. According to Z. J. Acs,

> "…small firms are the essential mechanism by which millions enter the economic and social mainstream of American Society….In this evolutionary process, community plays the crucial and indispensable role of providing the social glue and networking that binds together small firms in both high-tech and Main Street activities."[11]

New immigrants, in particular, rely upon small business for job opportunities crucial to their assimilation into American society – and, given the size and growth rate of the immigrant population within North Carolina, for economic growth[12]. For non-immigrants, however, it is currently unclear how these

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[8] Davis, Steven, Haltiwanger, John, and Schuh, Scott.
[9] Audretsch, David. "Small Firms and Efficiency". In Ãcs, Z. J. *Are small firms important? :Their role and impact*. Klewer Academic, Boston, 1999. p. 33
[10] Carlsson, Bo. "Small Business, Entrepreneurship, and Industrial Dynamics". In Ãcs, Z. J. *Are small firms important? :Their role and impact.* Klewer Academic, Boston, 1999. p. 106
[11] Ãcs, Z. J. "The New American Evolution" In Ãcs, Z. J. *Are small firms important? :Their role and impact*. Klewer Academic, Boston, 1999. p. 3-4
[12] Lustgarten, Steve. "The Role of Small Firms in the Upward Mobility of New Immigrants". Research Summary: Small Business Administration, Office of Advocacy, 2001.

opportunities compare with opportunity-generating programs available at large firms, such as diversity initiatives and first-source hiring agreements.

Another critical component of opportunity is job security. In their article "Is Small Beautiful for Workers", Dale Belman and Erica Groshen argue that job security is significantly lower in small firms, because "average job tenure in large firms is 8.5 years, compared to only 4.4 years in firms with fewer than 25 employees."[13] Data on average tenure, however, takes into account people leaving for voluntary and involuntary reasons, and therefore may not be a valid measure of job security. There is evidence that job tenure in large firms is longer because of the higher wages and benefits available to employees there, and therefore, if wages were comparable, the job tenure rates would not be as different as they currently are.[14] Even the fact that quit rates are lower in larger firms[15] might not be entirely valid, given that employers and employees often obscure the particulars behind an employee leaving a firm to preserve pride or unemployment benefits for the employee. Small firms do close at a higher rate than large firms, however, which confirms that small firms may provide less job security. However, small firms can also grow at a higher rate, providing greater opportunities for advancement. In this case, it seems as if working for a small new business may be a higher risk, higher reward proposition compared to working for a large established business. The important question in that circumstance is if there is enough job opportunity that employees are able to choose the size of firm in which they prefer to work.

Another argument in favor of small business is that employees can obtain more direct, hands-on experience working for a small company than for a large one. Working in a smaller establishment requires that employees do less specific jobs, which gives them greater opportunities to learn basic skills

[13] Belman, Dale, and Groshen, Erica L. "Is Small Beautiful for Workers?" In *Small Consolation: The Dubious Benefits of Small Business for Job Growth and Wages*. Economic Policy Institute, Washington, D.C., 1998, p. 5.
[14] Belman, Dale, and Groshen, Erica L., p. 27
[15] Ibid.

such as problem-solving, showing up to work, communication and following directions. These skills are applicable across all firm sizes[16]. As far as formalized job training, however, the research is mixed. In a 1992 study of training opportunities across firm sizes, researchers Dan Black, Mark C. Berger, and John Barron reached the conclusion that, while small firms provide fewer total hours of training in the first three months of employment, they do provide more training to employees with less than 12 years of schooling[17]. In addition, very small firms provide a significant amount of informal management training to employees without a high school diploma[18]. Larger firms, on the other hand, tend to provide more firm-specific training to more experienced workers[19]. This study did not include "learning by doing" or gaining knowledge through direct experience, which may have a higher incidence in small firms more than large ones due to the additional opportunities for in small firms. In addition, the benefits of formalized versus informalized training depend to a large extent on the nature of the position and the nature of the employee. While it can reasonably be argued that employees in smaller establishments get a broader array of experience, the experience may not necessarily be an advantage in their career or field. Ideally, however, institutional mechanisms would exist so that employees in small firms could receive comparable training to employees in large firms, particularly in more technical or process-oriented positions. In the end, different business cultures will appeal to different people. Only if there is a greater supply of jobs were in bureaucratically-organized companies than there is demand for jobs will a wage premium arise. The fact that theorists have not proven an existing wage premium based on work environment implies that this is less important than other job factors, or that most people find job environments they can accept.

[16] Black, Dan; Berger, Mark C.; and Barron, John. "Training Approaches and Costs in Small and Large Firms". Research Summary: University of Kentucky and Small Business Administration. 1993.
[17] Ibid.
[18] Ibid.
[19] Ibid.

Innovation Benefits

Small firms have long been applauded as innovators. While large multinational corporations, such as Proctor and Gamble, consistently turn out process innovations, many major product and industry innovations, particularly in high-technology industries, come from small organizations[20]. In his book *Success and Survival in the Family-Owned Business*, Pat Alcorn states that innovations are one of the most beneficial impacts of small businesses, especially as "…small business innovations per research-and-development dollar are as much as 4 times greater than medium sized firms and 24 times greater than in the largest firms."[21] As Zoltan Acs states: "New and small firms play a crucial role in experimentation and innovation that leads to technological change and productivity growth. In short, small firms are about change and competition because they change market structure."[22] This trend is not limited to a few brilliant ideas – the Small Business Administration states that small businesses "…obtain more patents per sales dollar than large firms, even though the latter are more likely to patent discoveries; this implies that small firms have more discoveries than large"[23]. The number and strength of existing entrepreneurship structures – business accelerators, angel investors, and venture capitalists – proves that small and new firms have long been sources of large returns, both for investors and for the communities in which the firms operate.

Small firms provide innovation benefits by behaving in very different ways than larger firms. Large firms have to split their focus between developing new ideas and maintaining the profitability of existing products and ideas, while small firms often focus on only one product or a small number of products. Small firms also do not have to support as much administrative burden as large firms, although recent

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[20] Acs, Zoltan, and Audretsch, David. "Innovation in Large and Small Firms: An Empirical Analysis" The American Economic Review, Vol. 78, No. 4. (Sep., 1988), pp. 680. Accessed 2/20/2008 at http://links.jstor.org/sici?sici=0002-8282%28198809%2978%3A4%3C678%3AIILASF%3E2.0.CO%3B2-R

[21] Alcorn, P. (1982). *Success and Survival in the Family-Owned Business.* New York, N.Y., U.S.A. McGraw-Hill. *P. 21*

[22] Ãcs, Z. J. "The New American Evolution" , p. 3

[23] Carlsson, Bo. "Small Business, Entrepreneurship, and Industrial Dynamics". In Ãcs, Z. J. *Are small firms important? :Their role and impact.* Klewer Academic, Boston, 1999. p. 107

outsourcing trends have made back-office functions arguably more efficient. Small firms can also be quicker to adapt to changes in the marketplace. Large firms have a role to play in the development of small firms. Industries that attract large firms, unless a larger firm structure is absolutely necessary because of low profit margins, tend to be fertile ground for smaller firms as well. Small firms can be significantly more innovative in these industries:

> “This suggests that, ceteris paribus, the greater extent to which an industry is composed of large firms, the greater will be the innovative activity, but that increased innovative activity will tend to emanate more from the small firms than from the large firms. Perhaps this indicates that, in industries composed predominately of large firms, the existing small firms must resort to a strategy of innovation in order to remain viable."[24]

This strategy of innovation has been extremely successful for small businesses, and can pay off for large businesses as well, if they acquire the smaller business or figure out a way to improve upon the original innovation. In any event, small businesses generate significant economic benefits, even in industries dominated by large businesses. The difference in innovation rates and types according to business size implies that a diversity of firm sizes will create a healthier economy, a critical insight for future economic development in North Carolina.

The innovation capacity of small firms is particularly amazing when compared against the sheer amount of intellectual capital and R&D spending in large firms. Small firms overcome this discrepancy in spending in a number of ways. Small businesses link together to form regional networks, utilize existing support structures such as Small Business Centers and Small Business Technology Centers, and employ talent with previous experience in a variety of larger firms. As a result, small businesses are regarded as an integral pipeline of new ideas and products, particularly in biotechnology firms where “…new products are developed in small, specialized firms that are often acquired by large pharmaceutical firms

[24] Acs, Zoltan, and Audretsch, David, pp. 687.

when the capital requirements for large-scale production and marketing escalate."[25] While small firms are certainly not entirely responsible for innovations in any industry, they are a vital part of a product development system that extends to businesses of all sizes and can also be an important part of a region's economy.

[25] Carlsson, Bo, p. 105

Chapter 2: Does Business Succession Pose a Threat to North Carolina's Economy?

It is clear that small business is important to the North Carolina economy, and that the employment potential and innovation intensity of small business jobs are worth developing. The question is: where can governmental assistance to support small businesses be the most efficient and effective? The previous chapter's exploration of small business suggests that firm age, rather than firm size, can have a positive impact on sustainable employment, wages, and regional stability. Anecdotally, this makes sense - every area has family owned businesses that have survived for several generations, and these businesses usually make a significant impact on both the economic and cultural well-being of the area. Some of these businesses, such as S.C. Johnson and Sons and Hallmark, can grow to become household names and major employment and economic drivers. Policymakers in North Carolina, and indeed the majority of the United States, have not yet explored potential interventions to extend small and family-owned business lifespan. If the state were to determine how to foster these family "institutions", the state economy would benefit both in long-term job creation, employee benefits, and revenues. In order to develop useful assistance, however, it is necessary to determine what, how, and when interventions would be the most effective.

If increasing the lifespan of small businesses is the goal, one potential and often overlooked area for state or regionally based technical assistance is the area of business succession. Business succession occurs when an existing business undergoes a change in ownership. This change can be voluntary, in the case of retirement, or involuntary, in the case of disability or death. The succession process is long and involved. In his book *Exit Strategy Planning : "Growing Your Business for Sale or Succession,* John Hawkey identified nine potential succession steps:

- Determine succession time frame
- Choose exit strategy
- Create continuity, taxation, and other structural plans
- Find and develop successor (individual or management)
- Removing or cleaning up any sale impediments
- Fostering inorganic and/or organic growth
- Finalizing preparations for disposal
- Revising personal financial planning based on business financial planning
- Disposal[26]

Business successions are often stressful, and can even cause the business to disintegrate. In fact, the most quoted statistic about survival of family businesses from generation to generation states that as few as 30% of family businesses survive a first change in ownership[27], and that these failures often occur within the first year after the owner leaves[28]. One study, investigating 200 businesses over a period of 60 years[29], showed that "the average life expectancy of a family-owned business in the United States is only about 24 years, which coincides almost exactly with the length of time the average founder remains active in company management"[30]. Clearly, ownership transition can be a dangerous time for small and family businesses.

The Consequences of Unsuccessful Transition

Ownership transition for business succession is a complex, often multi-year process with extremely high stakes. In its simplest incarnation, business succession consists of choosing an exit strategy, valuing the

[26] Hawkey, John. *Exit Strategy Planning : Growing Your Business for Sale or Succession.* Abingdon, Great Britain, Gower Publishing Limited, 2002. p 9.
[27] Lea, J. *Keeping it in the Family : Successful succession of the family business*. New York: Wiley, 1991. p 8.
[28] Fritz, Roger. *Wars of Succession: The Blessings, Curses and Lessons That Family-owned Firms Offer Anyone in Business.* Santa Monica, CA; Silver Lake Publishing, 1997. P. 9
[29] Ward, John L. *Keeping the Family Business Healthy: How to Plan for Continuing Growth, Profitability, and Family Leadership.* San Francisco, CA: Jossey-Bass Publishers, 1987. Appendix G.
[30] Lea, J. p.8.

company, and disposing of the business. Missteps at any of these phases can lead to business deterioration and even closure. Owners have four main exit strategies to choose from:

- Close the doors.
- Sell to an outsider or employee.
- Retain ownership but hire outside management.
- Retain family ownership and management control.[31]

Option one is obviously the most damaging from a wealth and job destruction perspective, but the other alternatives also contain potential pitfalls. If the business is sold to an outsider, the outsider may move the business and layoff the employees. While employee ownership, either by a single employee or through an Employee Stock Option Plan (ESOP) is a potential method to generate assets, it is not absolved from problems. If the employees are not trained to manage the business or always choose employee priorities at the expense of the business, the employees can lose both their jobs and their investment. Retaining ownership with outside management can create conflicts, and passing on ownership to a family member requires the interest of a competent successor and the ability to let that successor take control. Owners have some support in the company valuation and disposition aspects of succession from the accounting and law industries, but both processes can uncover unexpected surprises that may weaken businesses, and also are more complex and time-consuming processes than many owners realize. Therefore, each portion of the succession process needs to go reasonably well for the business to remain unharmed by the process.

In addition to business succession being a difficult period in the life of a business, it can also negatively affect the financial status of the owner herself. This can lead to significant wealth destruction, as owners risk the following with unsuccessful transitions:

- Losing their retirement income

[31] Bowman-Upton, N. B., & United States. Transferring management in the family-owned business. Washington, D.C.: U.S. Small Business Administration, 1991.

- Being forced to sell a business they may want to keep in the family
- Spoiling relationships with key employees and managers, and;
- Paying higher estate taxes[32]

Even if an ownership transition is beneficial to employees, it can hurt owners who have relied on their companies to fund their retirement but did not receive the benefits they hoped, either in purchase price or long-term profits. While firm closures may affect employees disproportionately to owners, these negative consequences will still significantly affect North Carolina's economy.

Is Business Succession Increasingly Likely?

The aging population of North Carolina, as with the rest of the United States, suggests business succession will likely become an issue affecting more small businesses in the years ahead. Existing data indicate that approximately 40% of US businesses are facing a succession issue at any given time. [33] This implies that up to 257,000 establishments in North Carolina may be about to experience a change in ownership. [34] Two recent surveys, however, indicate that this turnover may be more concentrated in the small or privately-held business segments.

A 2005 survey by PricewaterhouseCoopers queried CEO's of 364 privately-held, high-growth product and service companies with revenues from $1 million to $150 million.[35] This survey found that a majority of CEO's planned to retire in the next 10 years. This indicates that potentially many more firms are facing succession issues than previously anticipated, particularly in high-growth firms and industries that create significant economic development. Although there are not specific numbers for North

[32] Cross, Lisa. Successful Succession. Graphic Arts Monthly, 2002. 74 (8). 26-30.
[33] Bowman-Upton, N. B., & United States.
[34] From the total number of North Carolina Businesses of 642,597, from US Census Bureau - Economic Census: 2002.
[35] Ibid.

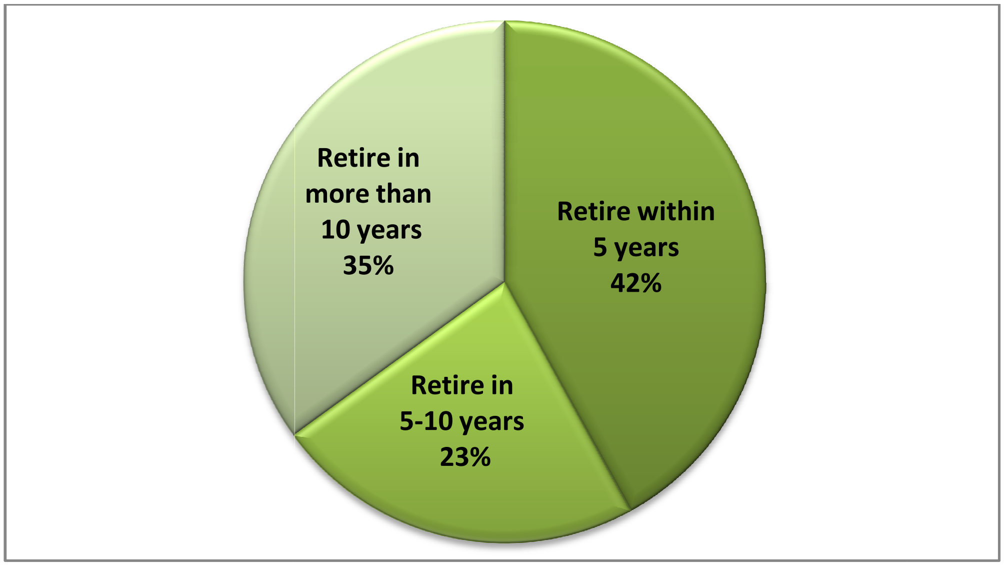

Figure 3: CEO Retirement Timeline[36]

Carolina, the state's high technology concentration implies that the state may contain a higher-than-average share of fast-growth companies, thus increasing exposure to succession risks. The anticipated exit strategies of the CEOs surveyed, however, did not immediately indicate that a significant number of businesses would close. More than half of CEO's anticipated a sale to another company, while others plan to sell to family or management. Somewhat distressing, however, is the fact that 17% of CEO's did

Figure 4: Anticipated Exit Strategies and Average Firm Size[37]

	Sale to Another Company	Sale to Family	Management Buyout
Percentage of Companies	51%	18%	14%
Mean Revenue Size	$23.5M	$44.1 M	$27.1M
Mean Employee Size	131	333	161

not have a specific exit strategy in mind at the present time. Although more 35% of CEO's do not intend to retire for more than 10 years, and it is possible that the majority of CEO's without current exit

[36] Collins, Pete, ed. Wide Majority of Fast-Growth CEO's Likely to Move on Within Ten Years, PricewaterhouseCoopers Finds. Trendsetter Barometer. New York, PricewaterhouseCoopers, 2005. p.1

[37] Collins, Pete. p. 3.

strategies are in this category, it is still concerning that nearly one-fifth of CEO's do not know what they will do with their businesses when they retire. In addition, 42% of CEO's did not have a contingency plan in case they were unexpectedly unable to lead the business. Although this is an unlikely circumstance, the increasingly likelihood that an owner may be incapacitated increases as the owner ages, and the potential impact of this incapacity is severe. Finally, it is important to note the mean size of these businesses, both in revenues and in employees. The average business sizes for owners planning a succession sale are all more than 100 employees and $23 million dollars in revenue per year. Assuming North Carolina's business community is similar to this survey's, businesses that don't survive the succession stage will make a noticeable negative impact on the state's economy.

The American Family Business Survey, conducted by Mass Mutual and the Raymond Institute in 2003, also investigated succession issues. In a survey of family businesses over 10 years old with two officers or directors with the same last name, results showed that "…an unprecedented power shift is anticipated", with 39.4 % of CEO's planning to retire (27.4% of respondents) or semi-retire (12.0% of respondents) over the next five years[38]. In addition, a total of 55.7% of companies expect their CEO to retire within the next ten years[39]. If, as the survey states, "…average CEO tenure at a family-owned business is as much as six times longer than at a typical non-family public company," [40] this may indicate that business succession is increasing in frequency, particularly in family-owned businesses.

For small businesses in North Carolina, it is difficult to determine what the potential impact of these potential retirements may be. These surveys, while insightful, are not state-specific or limited to companies with 500 employees or less. Retirement significantly increases with age, and there are no current studies. While the US Census Bureau's 2002 Survey of Current Business Owners shows that 10.9%

[38] MassMutual Financial Group/Raymond Institute. American Family Business Survey. Boston, Mass. MassMutual Financial, 2003. p. 2.
[39] MassMutual Financial Group/Raymond Institute. p. 3
[40] MassMutual Financial Group/Raymond Institute, p. 3

of firm owners were 65 or older, and 20.1% of firm owners were ages 55-64,[41] indicating that 30% of CEO's are now nearing retirement age, this is not specific to North Carolina, which may have a greater proportion of older and younger business owners overall. To truly determine whether or not succession is an increasingly important threat in North Carolina, additional studies would be useful. The existing literature, however, suggests that determining more about the retirement plans of existing North Carolina business owners would be advantageous.

The Potential Role for Government

State and local governments can be of significant assistance in management transitions. Some of the types of assistance well-suited to government intervention are already in place in other forms of technical and managerial assistance, but some will require new initiatives. There are several factors affecting the likelihood of management transitions, as listed in Figure 5. The items shown in larger text - improve marginal businesses, develop sound businesses, and create profitable businesses – are all tasks that the government currently has the resources in place to accomplish. In North Carolina, these services are provided by organizations such as the Small Business and Technology Development Centers, the Small Business Centers at each of the state's community colleges[42], and specialty services such as the Industrial Extension Service at North Carolina State University. These organizations are well-located throughout the state, and enjoy the respect of the local business community. There are even two organizations in the state dedicated solely to assisting family-owned businesses: the Wake Forest Family Business Center and the Family Business Forum of the University of North Carolina at Asheville, both of which offer seminars and some technical assistance for businesses in the state. While there are

[41]US Census Bureau. 2002 Economic Census Sector 00: Survey of Business Owners (SBO): Company Statistics Series: Statistics for Owners of Respondent Firms by Owner's Age and Business Interest: 2002 Accessed 6/13/2007
[42] North Carolina Community College System. *SBCN Regional Map.* Accessed 4/10/08 at: http://www.ncccs.cc.nc.us/business_and_industry/SBCNRegionalMap.htm

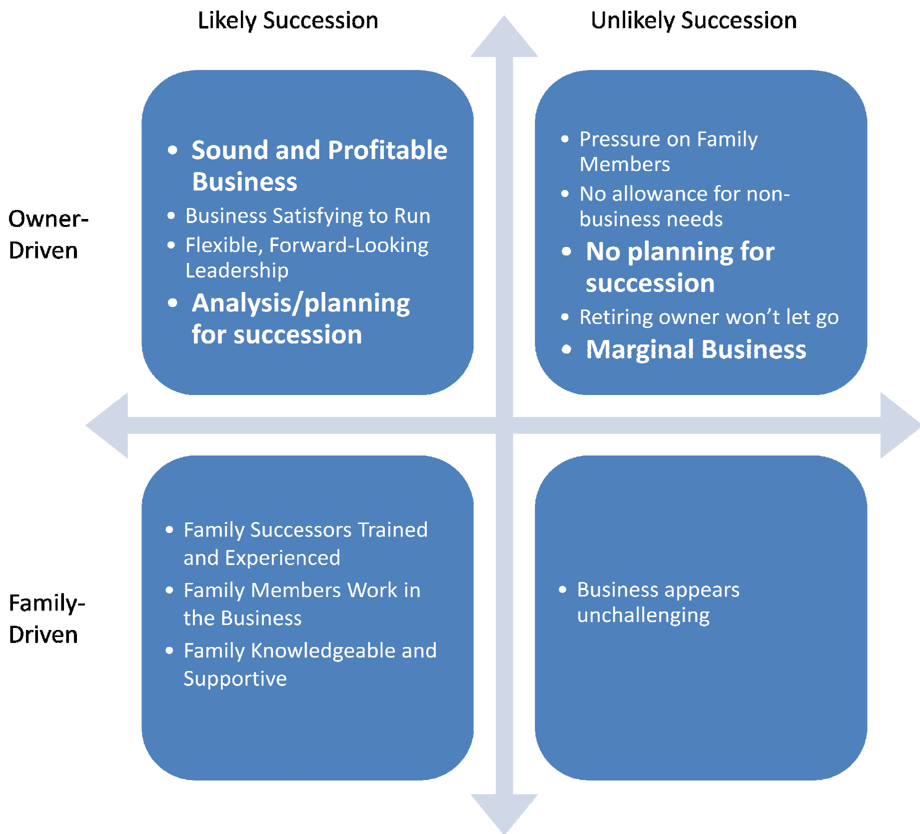

Figure 5: Factors Influencing Succession Probability[43]

undoubtedly areas for improvement in these services, owners have several options to pursue for helping ensure their business is sufficiently healthy to endure a transition.

Where North Carolina does not currently offer assistance, but has the potential to develop it, is in the area of succession planning. This area is particularly useful because few owners take the initiative when it comes to succession planning, either because they do not recognize the need for planning on their own, or because other priorities prevent them from developing timely plans. PricewaterhouseCoopers also queried the CEO's in their survey about the amount of succession planning they had undergone,

[43] Adapted from Figure 1.1 "Factors Influencing the Probability of a Successful Succession" Lea, J. (1991). *Keeping it in the family :Successful succession of the family business*. New York: Wiley.

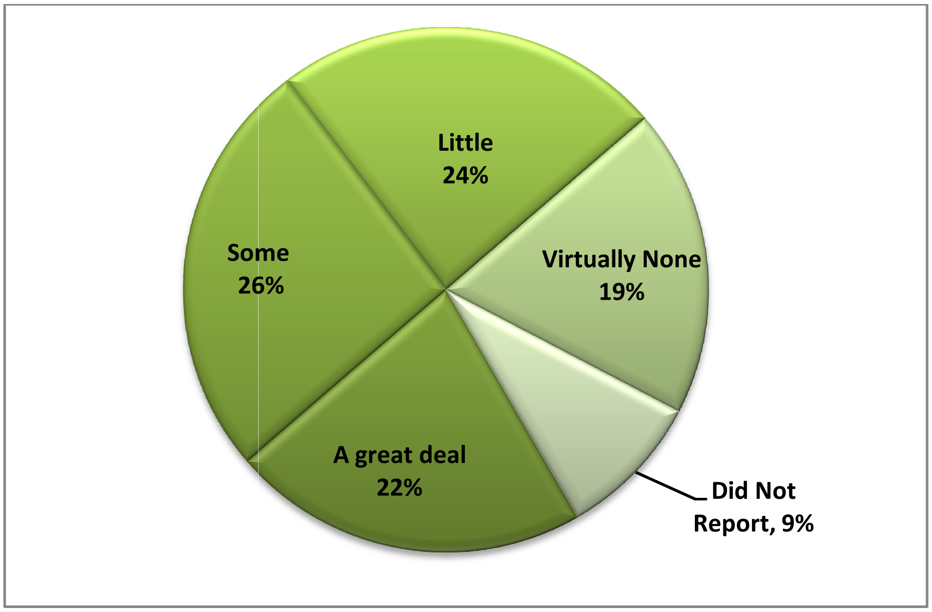

Figure 6: Amount of CEO Succession Planning[44]

with somewhat distressing results. While the scale measuring the amount of succession planning is somewhat subjective, it appears that a significant amount of the CEO's surveyed do not feel their succession planning is sufficient. A more telling measure might be that only 39% of these CEO's have identified a successor[45], a key step in succession planning. The American Family Business Survey results are somewhat more positive, as 45% of CEO's aged 61 or older that are expected to retire within five years have chosen a successor[46]. This statistic is balanced out, however, by the 13.4% of respondents in the AFBS survey who stated that the CEO would "never" retire, indicating that there are some psychological barriers to succession planning as well.[47]

Another reason it may be advantageous for government or non-profit institutions to take some initiative in helping businesses plan for succession is the amount of time required to create a viable succession plan. Although experts disagree somewhat on the ideal amount of time to spend planning before

[44] Collins, Pete. p. 3.
[45] Collins, Pete. p. 3.
[46] MassMutual Financial Group/Raymond Institute. p. 3
[47] Ibid.

implementing a management transition, the vast majority agree that it can take as many as 10 years to plan effectively. Here are three potential timelines, and the possible consequences of each:

- Short-term exit strategy: Less than 2 years. Will limit exiting options and sale price, potentially creating wealth destruction. May negatively impact successor selection, and eliminates most taxation-reduction options.
- Medium-term exit strategy: 2-4 years. May experience difficulty training a successor, and the company growth targets for sale may not be met.
- Long-term exit strategy: More than 4 years. This should be sufficient to achieve the majority of succession planning in most circumstances.[48]

These are aggressive planning targets, but could be met if the business owner is focused on succession. As the majority of small business owners are occupied with yearly, quarterly, or even day-to-day priorities, alternative organizations may be able to provide valuable long-term planning services. In addition, once the succession plan is complete, a good rule of thumb is to review the plan twice a year to make sure it still meets the businesses' needs[49]. This is particularly vital in the case of contingency succession plans or any plan that is not immediately implemented.

The main reasons that economic development actors should consider assisting businesses with succession planning, however, are the psychological barriers that prevent business owners from creating smooth management transitions. In his book *Wars of Succession,* Roger Fritz states that "Many owners of family business are uncomfortable with planning for the succession of management in their businesses after death or retirement," even though failing to plan "…can be disastrous to the long-term future of a business."[50] As a result, delays in succession planning are common, arising from "the intense involvement the entrepreneur has with the business increases the importance of the job and his or her

[48] Hawkey, John. p 9.
[49] Vinas, Tonya and Jusko, Jill. (2004). Five Threats that Could Sink Your Company. *Industry Week.* September, 53-61.
[50] Fritz, Roger. *Wars of Succession: The Blessings, Curses and Lessons That Family-owned Firms Offer Anyone in Business.* Santa Monica, CA; Silver Lake Publishing, 1997. P. 9

identity," where "removal from work is like losing a part of oneself."[51] Many of the publications that address the subject of business succession, particularly in family-owned businesses, have stories of the owner who cannot let go of running the business, even after it places a burden on both the business and the owner. Examples range from the tragic – the owner dies suddenly and family members must determine what to do with the business - to the ludicrous – the 65 year old son waiting for his 95 year old father to decide he's finally ready to run the business[52]. Owners often fear retirement for personal, financial, and social reasons. These fears may overwhelm the owner's initiative to do what's good for the business, the concerns of employees or managers, or even the expressed desires of other family members to take on a greater leadership role or to ensure that the owner has a chance to enjoy retirement. This gives local and regional institutions a unique and vital role to play in providing support

Personal	Financial	Social
• Identity linked to business • Self-respect linked to ownership • Concern for future of Business • Business provided structured time	• Accustomed to salary or benefits • Business is large portion of owner's assets • Profits from sale may be below expectations	• Loss of Interaction • Status linked to ownership • Loss of public exposure • Loss of influence in community

Figure 7: Owner's Potential Retirement Fears[53]

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[51] Ibid
[52] Nawrocki, Tom. (2007). Family planning: a rough guide to business succession. Inc. 29 (8), 108-109.
[53] Adapted from Bowman-Upton, N. B., & United States. (1991). Transferring management in the family-owned business. Washington, D.C.: U.S. Small Business Administration.

to owners to make plans for management transition. As outside agencies, these institutions can bring up realities about the succession situation that employees or family members might not be able or willing to. As local entities, they can emphasize the benefits of the business to the area, hoping to invoke the owner's sense of community to encourage planning for transition.

Organizations could fill existing succession planning gaps in several areas: analyzing potential exit strategies, finding viable successors and assessing and valuing the existing business. There are some North Carolina organizations that already provide some of these services such as the Family Business Centers and the Family Farm Transition Network, which offers technical assistance and maintains a network of "retiring and aspiring farmers."[54] As economic development resources are not infinite, before beginning a project of this magnitude North Carolina policymakers should carefully consider the benefits of providing succession planning technical assistance. The existing data clearly show that the lack of business succession planning negatively affects small and family-owned businesses. Several sources suggest that more businesses will be turning over as the U.S. population ages, and that not all of these business owners have considered what will happen with their business when they retire. What's missing, however, is concrete data about *North Carolina* businesses. The following chapter will explore potential survey methodologies to determine the potential extent of the business succession exposure, in terms of employee jobs and business revenues at risk, in small companies in North Carolina.

[54]The Family Farm Transition Network. Mission Statement. Accessed 2/29/2008 at http://www.ncftn.org/aboutus/Mission%20Statement/view

Chapter 3: Determining the Need for Succession Assistance

In order to determine if North Carolina small and family-owned businesses would benefit from succession planning assistance, it is vital to know how many companies are currently facing this issue. In order to determine whether it is in the best interest of North Carolina policymakers to attempt to provide this assistance, it is important to evaluate the potential impact of unsuccessful management transitions on the North Carolina economy. Yet existing information regarding the status of business succession plans, or even about the ownership status of small firms, is not readily available. Therefore, this Masters Project has developed and tested an online survey instrument to measure the economic risk posed by small business succession in North Carolina. To develop an instrument that will provide an accurate measure of risk, a researcher must consider several key criteria: how to select the survey population, how to truly assess succession preparedness, and how to interpret the results.

Selection

There are two significant difficulties when it comes to selection. The first is how to define and measure a small business. The Small Business Act defines a "small business concern" as "one that is independently owned and operated and which is not dominant in its field of operation,"[55] with the actual amount of employees varying by industry. So the standard definition of 500 employees or less may or may not be appropriate given the industry. Businesses can also easily move in-between size classes over time. The Small Business Administration evaluated four different methods of measuring business size: quarterly base-sizing, annual base-sizing, mean-sizing, and dynamic-sizing, and discovered

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[55] Small Business Administration. "What is Small Business?" Accessed 12/5/2007 at http://www.sba.gov/services/contractingopportunities/sizestandardstopics/size/index.html

that the methodology could significantly vary results of empirical research[56]. For the purposes of creating a survey that will accurately measure small business exposure, it may be better draw from a large sample of businesses rather than trying to restrict the sample by the existing number of employees at a firm. A survey sent to businesses of all sizes, or even just businesses with 1000 employees or less, which would contain questions designed to accurately measure business size as defined for the purposes of the survey, may be a better option than using an existing database of business size. As there are far fewer companies with more than 500 or 1000 employees than there are companies with employees below those amounts, sampling all businesses will still result in a large proportion of usable surveys.

The second difficulty is how to determine if a business is, in fact, "family owned", or even independently owned. Methods used in existing studies of family business include looking for companies who have officers or board members with the same last name[57], searching for businesses in a certain age range[58], or simply examining sole proprietorships and limited partnerships[59]. None of these methods, however, are particularly effective at identifying the businesses, family-owned or otherwise, that may have succession issues. According to the American Family Business Survey, the vast majority of family businesses do business as S corporations (closely held businesses with less than 100 shareholders) or C corporations (publicly or widely held businesses) - 47.2 percent and 42.3 percent, respectively[60]. Therefore, examining sole proprietorships, limited liability or general partnerships or even limited liability corporations will not yield a fair accounting of family or independently owned businesses. Looking at businesses whose officers or board members have the same last name, while it will identify

[56] Butani, et. al. "Business Employment Dynamics: Tabulation by Employer Size". Small Business Administration and Bureau of Labor Statistics, Washington, D.C., 2005.
[57] MassMutual Financial Group/Raymond Institute, p. 7
[58] Ward, John L. *Keeping the Family Business Healthy: How to Plan for Continuing Growth, Profitability, and Family Leadership.* San Francisco, CA: Jossey-Bass Publishers, 1987. Appendix G.
[59] PricewaterhouseCoopers, 2005. p.1
[60] MassMutual Financial Group/Raymond Institute, p. 9

some businesses that are family operated, is prone to error due to married names and people with the same last name who remain unrelated. Examining companies by age may identify businesses that have moved on to a second owner, but because business founders often remain in control of businesses longer than anticipated, choosing a firm age old enough to ensure that a firm has endured at least one management transition would leave many businesses out. Examining existing data, therefore, is not likely to provide an accurate count of the types of business sought. To accurately identify whether a business is independently or family owned, one may have to ask the owner directly.

This Masters Project examined a number of ways to select the population for a business-succession survey instrument. Initially, the businesses were to be selected from the National Establishment Time-Series (NETS) database. After investigating the issue with several people knowledgeable with the database, it became clear that the database could only sort companies by age and/or owner's age, which is not an efficient way of locating family businesses. A second recommended population was the North Carolina manufacturers who use North Carolina State University's Industrial Extension Service (IES). This limited the survey population by industry, and, perhaps more critically, by businesses who have already expressed interest in receiving technical support. This is a critical issue, as companies who make an effort to seek out assistance for current issues may be more likely to face potential issues, such as management transition, earlier and more forthrightly than other businesses.

For the purposes of the pilot study, the survey sample was drawn from three sources: businesses identified as "family-owned" by individuals at IES, and the membership lists of both the Asheville Family Business Forum and the Wake Forest Family Business Center. A total of 106 businesses were identified, and contact information (fax number, e-mail address, or both) was located for 91 of these businesses (businesses using the Charlotte branch of the Wake Forest FBC but located in South Carolina were specifically excluded). E-mail addresses were located for 71 of those businesses, although 8 of those e-mails did not reach the recipient. Of the remaining 63 e-mails, 32 e-mails referenced the owner's name or a specific recipient rather than a general recipient such as "info@company.com" or "sales@company.com". While sending to a general e-mail address does not necessarily preclude a response to the survey, it may make responses less likely. 28 of the businesses identified received the survey request by fax. The faxed survey request contained the link to the internet survey as text that needed to be input into the computer. It also stated that people interested in participating could contact me at my e-mail address.

While 91 businesses, even with the limitations listed above, should comprise reasonable number for a pilot survey, there are some concerns with using the same sampling frame for a full-scale study. First, the businesses are somewhat geographically located, as they depend to a great extent on businesses using family-business services in Asheville, Charlotte, or the Triad area of North Carolina. Secondly, the businesses identified as family businesses by the IES came from individual account managers at IES regional offices. These individual account managers can probably determine the family owned status of a business reasonably well, but they are not infallible. In identifying family businesses, there is a distinct tendency to identify those businesses that have been in operation for multiple generations. While these businesses may experience some issues with ownership transition, it is a cycle they have completed before, and therefore they may not need technical assistance to the same degree as businesses attempting their first transfer. This is even more evident when looking at businesses who have self-selected to be involved with a family business organization – the majority of these businesses are the community "institutions" that serve as good examples, but not necessarily as assistance candidates. In all, 37 of the 106 businesses, or 34.9 percent, advertise being multi-generational businesses.

In taking the survey from pilot to full-scale, it is critical to determine a sampling frame that will include not just family-owned businesses, or even ones that have completed one or more successful ownership transitions. Because a business has several succession options, and transitioning the business to the next generation is just one option, it is important to take a sample from the full range of small businesses, and perhaps even from businesses of all sizes. Because firm age is not a good proxy for owner age, firm age is not a reliable sampling criterion, though it is important in determining whether or not a business should be planning for succession. There are two potential sampling frames that address these concerns: regional sampling and industry sampling. A regional sampling frame, in which all businesses in a specific geographical region (a county, preferably) are surveyed or sampled to survey and the small and family-owned businesses, as well as those needing technical assistance, are narrowed

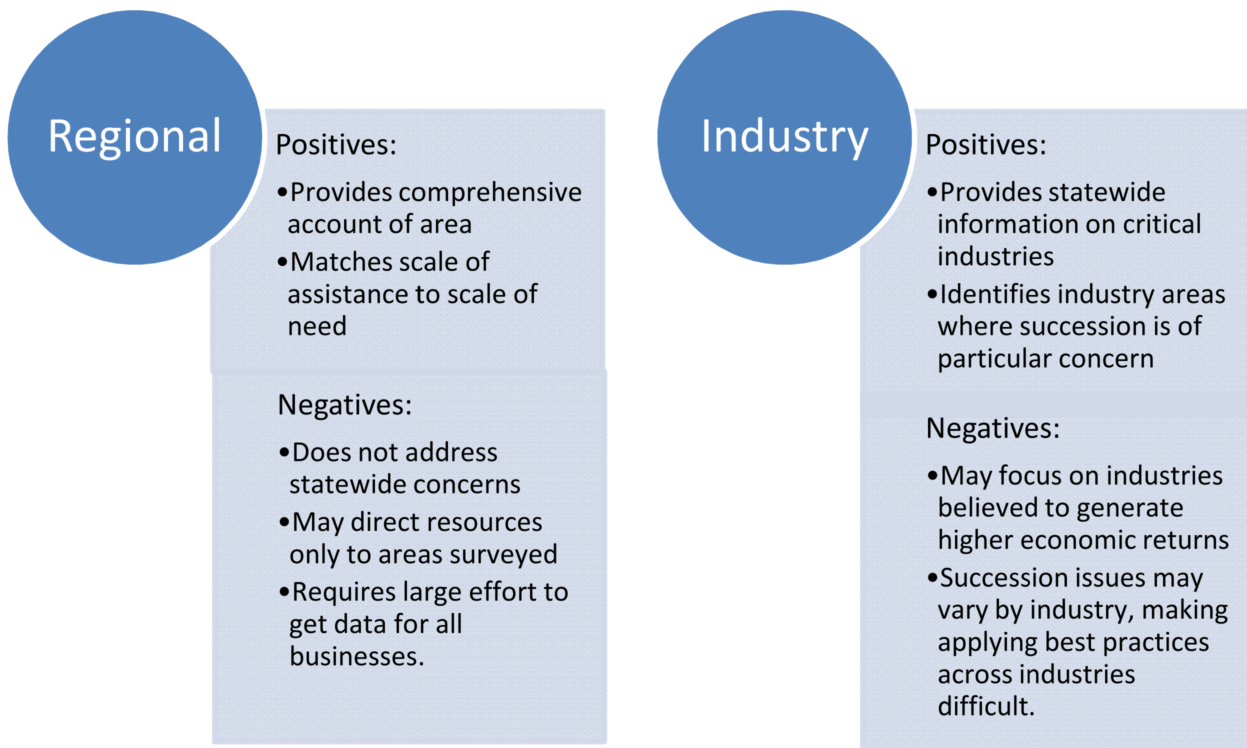

Figure 8: Regional Versus Industry-Specific Sampling Frames

down using survey questions. An industry sampling frame would select participants from businesses around the state in a particular industry. Depending on the level and amount of information required, one or both of these sampling frames may be used. Regional or industry combinations may also be of some use - for example, succession planning in rural areas of the state, or industries relating to specific state or regional industry clusters. These types of succession studies may interest governmental or non-profit institutions with missions in these areas, such as the North Carolina Rural Center or regional Economic Development Groups.

Survey

Once an appropriate sampling frame has been selected, the questions must be carefully created to obtain responses about both the owner's perceived succession preparation status, and whether that preparation is enough to achieve a smooth transition. Because retirement is a sensitive issue among business owners, and particularly among business founders, it is likely that survey answers will be somewhat subjective, even after attempting to write objective questions. For example, an owner who responds that her level of succession planning is "adequate" may simply mean that they have planned sufficiently for where the owner perceives they are in the succession cycle. For someone who plans to retire in 20 years, this may be as little as the unfounded assumption that a relative will take over the business for them, or as much as a detailed contingency plan. Therefore, the survey must ask a series of questions designed to determine both the amount of succession planning the owner has done, *and* the amount of planning that might be appropriate given other business factors. Subjective questions such as "when do you plan to retire?" are a good start, but a survey that truly attempts to determine the actual need for succession planning needs to verify these answers with objective criteria.

A good potential check is to determine the age of the primary owner. Age data can also be used to determine those at low, medium, and high risk for stressful ownership transitions. For example, Pat Alcorn writes that owners past a certain age will fail in their succession efforts: "after 70, those who have not prepared for succession are going to die with their boots on; there is no longer any point in talking to them about preparation for anything."[61] This may be an extreme opinion, but an owner approaching or at retirement age that has not yet planned for succession would certainly be a priority for technical support. Another check is to specifically ask owners about the state of their business, and if it would be worth developing a succession, or at least a contingency, plan despite the owner's age. This can determine if the business is one that is even transferrable in the first place. For example, sole proprietorships that depend on the owner's specific expertise may not be able to transition to a new owner, unless that owner has the same amount of expertise. For businesses that can be transferred, however, James Lea defines several milestones that indicate a potential need for succession planning:

> "[It] should start early, probably as soon as the business gets past the fight-for-survival stage and achieves real momentum. When the founder decides that the business is solid, profitable, personally rewarding, and worth hanging onto, planning for succession should begin"[62]

Asking owners whether their businesses meet these criteria is another way of determining succession needs objectively. To determine succession readiness, the survey needs to ask specific questions about the steps in the plan, rather than a generic amount. Asking owners if they have identified a successor, valued the worth of the company, shared their succession plans and examined possible estate implications business ownership is a far more accurate way to determine the actual amount of planning that has taken place.

Taking into account these considerations, I have designed a pilot questionnaire. This survey asks the owners of firms a series of questions designed to elicit four main indications of succession readiness:

- Whether the business is at a point in its lifecycle where a management transition might be imminent within the next 10 years. This will be assessed through both the owner's beliefs about when she will retire and by assessing the owner's age.

[61] Alcorn, P. (1982). p. 219
[62] Lea, J. (1991). *Keeping it in the family :Successful succession of the family business*. New York: Wiley. p. 182

- Whether the business is a potential succession candidate. This will be assessed through questions assessing the stage of the business, the importance of the owner to the business, and, indirectly, through the firm revenues and number of employees.
- What specific succession steps have the owner has taken. This will be assessed through a series of yes/no questions for potential succession steps.
- Whether an appropriate successor is in place. This will be assessed by asking if a successor has been identified and whether or not there are adequate systems in place to train them.

The Master's project will complete a preliminary analysis of the sample data to determine if succession issues are important to businesses that self-identify as family-owned, or if most of these "institution" businesses in the sample have these issues under control. This may provide insight on where to focus the full survey.

Results

A total of 19 businesses responded to the survey, a response rate of 20.8%. This is not a high response rate, and suggests (but does not confirm) that the survey limitations had an effect on the response rate. As the response rate is not ideal, and the sampling frame relies on several small populations not coincident with the target population rather than random selection of the target population, the results should not be assumed to represent the target population. Examining the responses of the businesses who completed the survey, however, can provide ideas as to what questions should be adjusted for the full survey, as well as what additional inferences could potentially be made with a larger sample of businesses, either comprehensive or randomly selected from one of the above sampling frames.

Description of Survey Respondents

Ten of the 19 respondents who answered the question (53%) identified themselves as being in the manufacturing sector, with the remaining businesses identifying themselves as being in the construction, food manufacturing, transportation and warehousing, professional services, and health care sectors.

Four businesses also identified as being in the ‘other sector’. The concentration of businesses in the manufacturing sector may be a result of the portion of the sampling frame that came from the Industrial Extension Service. The three ‘other’ responses may indicate that these businesses are not familiar with standard NAICS classifications, and another method for determining industry sector may need to be identified in the full-scale survey.

These businesses employ from 2 to 100 employees, with a mean of 35.78 employees and a median of 41 employees. Only 4 of the 19 businesses employ less than 10 employees. This range suggests that perhaps the survey is not addressing businesses on the large and small ends of the spectrum, potentially due to the businesses available from the sample population being affected by self-selection bias. Small companies may not know about the Industrial Extension Service, Family Business Forum or Family Business Center, while businesses over 100 employees may have in-house expertise to deal with these issues, or see themselves more as corporations than family-owned businesses. Business revenue among the 16 companies who answered the question varied between $1.2 million and $16 million, with an average of $5.28 million and a median of $4.5 million. Two of the 16 companies who answered, however, stated zero or “not applicable” for their revenues. Therefore, the average revenue for all companies who reported actual revenue was $6.04 million and the median revenue for these respondents was $5 million.

Responses About Succession and Succession Planning

The businesses who responded have been in operation from one year to 79 years, with a mean of 23.5 years and a median of 16 years. The 16 present owners who responded have owned the businesses from 1 to 60 years, with a mean of 16.5 years and a median of 12 years. These data indicate that there has been at least some ownership transition among these companies. Indeed, four businesses indicate that they either have a second owner or have owned the business for less time than it has been in operation. However, the owners of two of the businesses who have been in operation the longest, 60 years and 79 years, have owned the company for 60 years and did not respond, respectively. Another business that has been in operation for 63 years has an owner who has owned the company for 33 years. In the overall population, 37 of 106 businesses, or 34.9%, indicated that they were multi-generational. Assuming a "multi-generational" business has been in operation for greater than 24 years, the sample indicates that 4 of 16, or 25%, of the businesses who answered the question reported having been in business for greater than 24 years. The probability that the sample contains so few multi-generational businesses compared with the population is 15.6%, suggesting but not confirming some response bias in that single-generational firms may have been more likely to answer the survey than multi-generational firms. If this is the case, the results reported from the survey may overstate the need for succession planning assistance, as, presumably, firms who have already transitioned management from one generation to the next need less help transitioning the company from the second to third generations. The greater issue, however, surrounds the assumption that only older companies have owners who are in need of succession assistance. While this analysis can identify some businesses as potentially in need of succession assistance, it may only highlight the extreme cases.

The data on business owner age and retirement plans highlights a few more companies that may be succession-ready. The vast majority of business owners who responded were over the age of 44 (83%, 15 out of 18 responses), which, assuming a retirement age of 55, may indicate that many owners are entering a succession-planning horizon. Refining the age-ranges in the full-scale survey, perhaps down to 5-year increments, will help better define if owners should be planning for succession simply due to their age. 11% of owners are over 65, indicating they should have a succession plan in place.

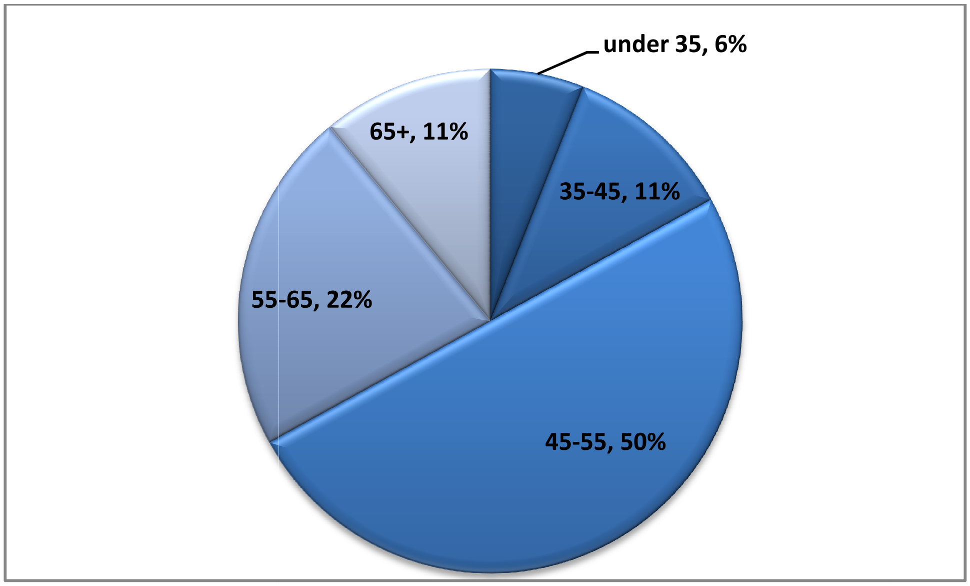

Figure 9: Age of Business Owners of Respondent Companies

When viewed against the reported years until retirement of owners, however, there does seem to be a reasonable match between ages and desired retirement ages. A cross-tabulation indicates that the two owners who reported being over 65 reported being ready to retire in the next 5 years. The majority of

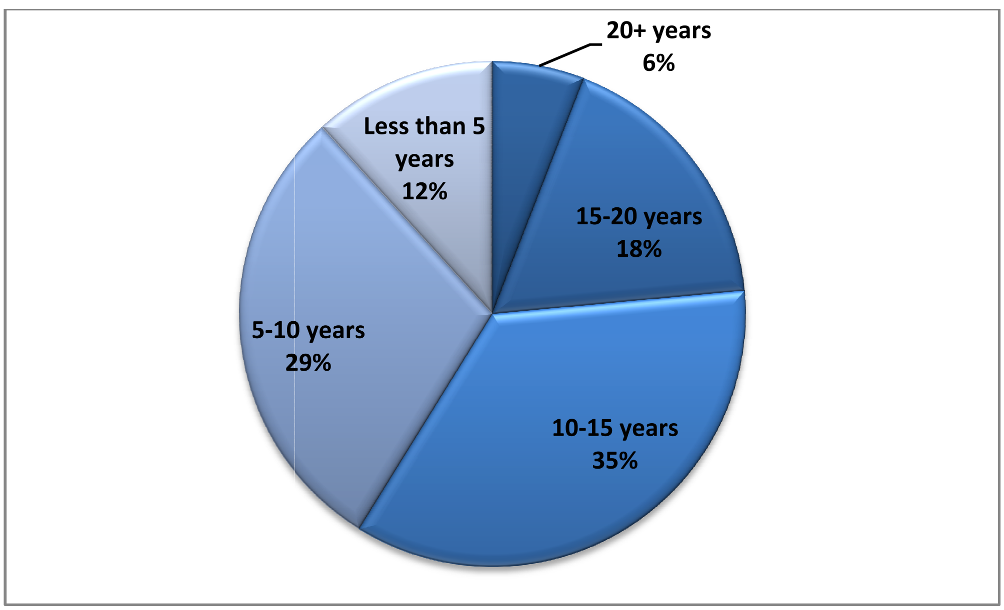

Figure 10: Number of Years Until Owner Plans to Retire

owners between 55-65 years of age (75%) indicate their intention to retire within 5-10 years, with 25% of owners in this age group intending to retire within 10-15 years. There is significant variation, however, in the 45-55 years old age segment, with 25% reporting an intention to retire in 5-10 years, 62.5% intending to retire in the next 10-15 years, and 12.5% intending to retire within 15-20 years.

Using the criteria of business viability rather than owner age or years until retirement is another way to determine succession readiness. Examining what respondents reported in these areas indicates that many more companies may be ready for succession plans than indicated by firm or owner age or retirement status. All of the companies stated that they were in either the growth (78%) or maturity (22%) phases of their business cycles, which indicates the companies are good candidates for succession planning as they are growing or stable. Asking this question directly, however, may be somewhat misleading, as owners may state the phase of the business cycle they believe they are in, rather than the phase they are actually in. A more accurate yet more complicated way to ask this question is to ask for sales revenues for the past three years and analyze the results. This data may also be available in the NETS database. Profitability is more difficult to determine, as owners may be reluctant to disclose profits, even in an anonymous survey. This survey instead asks if the business owner is the primary or most important business asset. Two-thirds of respondents (67%) answered this question in the affirmative, indicating that the business may not be a good succession candidate. A follow-up question regarding whether or not the owner can successfully transfer her knowledge to a new owner may help assess the transition potential. If policymakers wish to use the full-scale survey to identify businesses in need of contingency planning, however, asking owners if their continued work is vital to the life of the business is a very good indicator. 56% of respondents asserted that they had a plan for the incapacitation or death of the primary owners, which indicates that these owners are attempting to reduce the risk of a leadership crisis, but 44% did not have a plan, significantly greater than the 33% of owners who did not believe they were their business' most important asset. In the full survey, this gap should be analyzed to determine the amount of employees and revenues at risk from lack of contingency planning.

In order to determine whether or not technical assistance is necessary in helping businesses achieve successful ownership transitions, this survey must evaluate the extent of existing succession planning of individual firms. The initial responses are somewhat surprising, as the majority of owners (89%) stated that they had not prepared a formal succession plan, but a significant number of owners have:

- Identified a potential successor (11 out of 16, or 69%)
- Shared their retirement/ownership transition plans with others[63] (17 out of 19, or 89%)
- Have developed an estate plan (14 out of 18, or 78%)
- Identified a current exit plan for the business (18 out of 19, or 95%)

All of these are important components of business succession, which indicates that owners may be thinking about succession but have not finalized any plans. The pattern of responses in the survey also indicates that the succession readiness questions may have an additional purpose in identifying the specific succession assistance needs of businesses. For example, while 69% of respondents have identified a potential successor, only 56% of respondents stated that there was a system in place to train those successors. Technical assistance may be useful in filling gaps such as these. Assistance also may be useful in identifying transition options owners are currently unaware of. In the pilot survey, none of the owners listed a management buyout as an exit plan, and only one owner mentioned the possibility of selling the business to employees. A majority of owners stated they would turn over the company to the next generation (61%), followed by selling to another company (33%), and finally selling to employees (6%). The categories of exit plans which may put jobs at risk are selling to another company and selling the assets and closing the business, so determining if businesses are unaware of other

[63] 24% of owners have informed senior management, 18% have informed non-managing family members, 53% have informed managing family members and 6% have told all employees.

options that would not necessarily put jobs at risk (such as management or employee buyouts), may be useful assistance for policymakers to consider providing.

Another area where the survey should seek to identify potential gaps is in the area of perceptions about succession planning. Only 65% of respondents believe that the next generation of management has the same commitment to the business that the current generation does. If it is determined that a perceived lack of commitment is a reason for delaying retirement or even succession planning, it may be worth addressing. The other perceptions that policymakers may seek to address are the importance of succession planning to a business and where succession planning should be on a list of priorities. Respondents are divided on whether or not succession planning is important to a business, and tend to rate planning for succession equal or lower than other priorities. If this trend holds, it may be that businesses would benefit from additional education about the need for adequate and formalized succession planning.

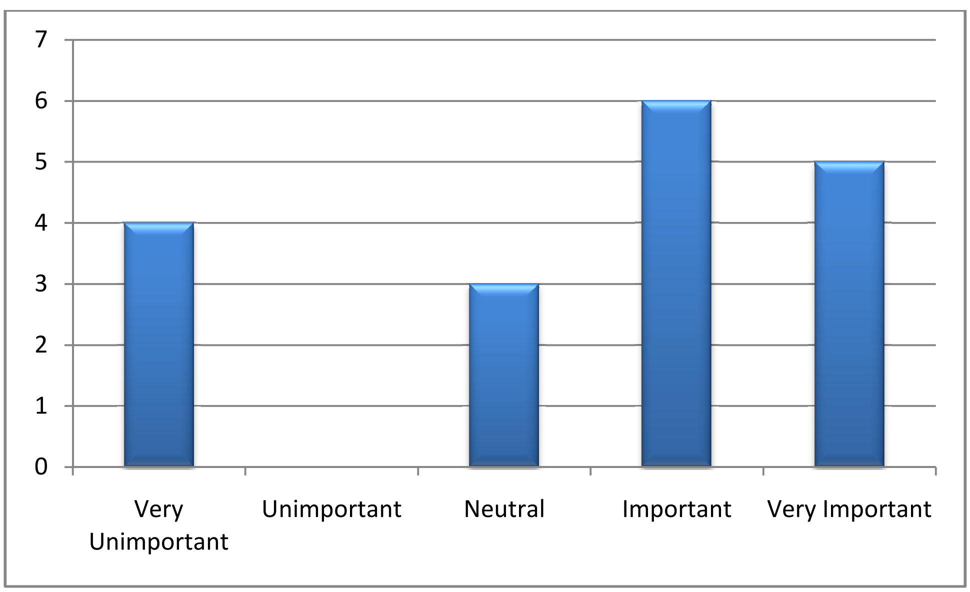

Figure 11: Importance of Succession Planning to Business Owners

Recommendations for Full-Scale Study

This pilot study has revealed some best practices and advisable techniques for a full-scale study. The recommendations are divided into three categories: sampling frames, survey techniques, and question formation. Perhaps the most difficult of the three is finding the correct population of businesses. Businesses that currently identify as family businesses, the population considered in the pilot survey, may have a greater idea about the need for succession planning, and may have a larger percentage of multi-generational businesses than the small business population as a whole. So surveying self-identified family businesses alone may overestimate the succession readiness of the small business community. There are also difficulties inherent in accurately measuring whether a business fits into the category of 'small' at any given time based on the number of employees. To remedy these issues, the population surveyed should be strictly inclusive of family-owned or small businesses, and should use the survey itself to narrow down the firms that fit into the appropriate categories. Therefore, the full survey should sample from firms with up to 550 employees if possible (up to 200 if the survey chooses to define 'small businesses' as firms with 100 employees or less), to account for measuring inconsistencies, and survey owners as to their current number of employees. The full survey should also not ignore businesses that are not identified as family-owned, and should sample from C and S Corporations as well as LLP's, PC's, and partnerships or sole proprietorships. Oversampling identified family-owned businesses is a possibility, but should be noted and carefully studied, as a preponderance of established family businesses may cause the survey to underestimate succession problems. By sampling a larger population of state businesses and asking them to objectively categorize themselves, the true need for succession planning among these businesses will be easier to discern.

As the family businesses in the pilot represented a wide range of industry sectors, the full survey would provide the most accurate information for policymakers if it is not restricted by industry sector. If the entire population of small businesses in North Carolina is too large of a population to easily survey, one potential smaller sub-population would be one of the Economic Development Regional Partnerships, such as AdvantageWest Economic Development Group or the Research Triangle Regional Partnership. An industry-specific survey, if conducted, should make certain that the businesses identified are truly within the industry sector and not somehow miscategorized, especially as business owners may not have a clear idea of their firm's industry sector.

It is critical that the surveys reach either the owner of the firm herself, or someone extremely familiar with succession plans of the firm. As 11% of respondents in the pilot survey did not report that owners had shared their succession plans with employees, an employee of the firm, even one in a managerial role, is unlikely to be as good of a resource as the owner. To increase the likelihood of the survey reaching the owner, every attempt should be made to get e-mail addresses of owners in order to distribute the survey directly. If e-mails are not readily available, the survey should be mailed directly to the owner and should include a self-addressed, stamped envelope for the survey's return. Fax is another potential option for survey distribution, though researchers should ascertain if faxes sent to a publicly-available fax number are likely to make it to the owner.

Finally, the survey itself should be carefully constructed to determine the true extent of succession needs. The survey must determine the owner's age and their desired retirement date, the succession potential of the firm, whether a successor has been selected and trained, and the specific succession steps a particular firm has taken. For many of these questions, quantitative responses will be more insightful than quantitative ones, as asking respondents to choose a distinct category may prevent them from overstating their readiness due to lack of urgency or knowledge. At the same time, potentially sensitive questions such as age, desired retirement date, and preparation of contingency or estate plans should be grouped into small categories so owners do not feel uncomfortable addressing a potentially emotionally-charged subject. Ideally, time or age would be measured in five-year increments, and questions assessing levels of interest or preparedness should be evaluated on a five-point scale. In addition, owners may see a request to record their names and their yearly revenues as a breach of confidentiality. Therefore, the survey should either ask for business names in order to connect firms with high-risk successions with appropriate assistance or should ask about revenues to get a true extent of the problem North Carolina may face from upcoming business successions. In any event, Researchers must gather several different criteria about each business in order to derive an accurate measure of succession readiness. As a result, the full survey will be somewhat lengthy (the pilot survey contained 22 questions), and researchers may want to consider providing an incentive to increase participation, particularly if researchers are not affiliated with a well-known organization.

Conclusion

It is clear that learning more about the amount of preparation North Carolina businesses have done for ownership succession would help guide policymakers and organizations who offer technical assistance to businesses. The personal difficulties potentially inherent in leaving a successful and rewarding business, however, make it difficult for owners to confront, and difficult for researchers to ask about directly. Researchers can manage these complexities with a properly designed survey, sampling frame, and analysis to determine if owners need assistance planning for business succession. If the survey identifies a lack of planning, potential successors, accurate valuations, or other threats to viable business succession, researchers and policymakers should work together to craft a non-intimidating yet effective response plan.

Appendix A: Business Succession Survey Questions

#	Question	Answer 1	Answer 2	Answer 3	Answer 4	Answer 5
	First, we will ask some basic questions about your business. Please answer to the best of your ability.					
1	What Industry are you in?					
2	How many years has your firm been in operation?	number				
3	How many employees does your firm have?	number				
4	What was the revenue of your firm last year?	number				
5	How long have you owned the firm?	number				
6	What stage is your business in currently?	Startup	Growth	Maturity	Decline	
7	How often do you conduct company valuations?	Never	Every 10+ years	Every 5-10 years	Every 3-5 years	Every 1-3 years
	Now we will ask some questions about you, the business owner. Please answer to the best of your ability.					
8	How old is the business owner?	under 35	35-45	45-55	55-65	65+
9	How many years before the business owner plans to retire?	20 +	15-20	10-15	5-10	Less than 5
10	Is the business owner the most important asset in your business?	Yes	No			
11	Have you planned for the unexpected death/incapacitation of the primary owner/s?	Yes	No			
	Now we will ask some questions about your future business plans and goals.					
12	What is your current exit plan for your business?	Sell to another company	Management buyout	Transition to next generation	Sell to Employees	Sell assets and close business

13	Have you shared your succession/retirement plans with:	Senior Management	Non-managing but inheriting family members	Managing Family Members	All Employees	
14	If you plan to sell to management, transition to the next generation, or sell to employees, have you identified a potential successor?	Yes	No			
15	Is there a system in place to train and develop potential successors?	Yes	No			
16	Do you feel the next generation of management has the same commitment to the business that you do?	Yes	No			
17	Have you developed a formal succession plan?	Yes	No			
18	If so, how often do you review the succession plan?	Never	Every 5+ years	Every 2-5 years	Every 1-2 years	More than 1 time per year
19	Have you developed an estate plan?	Yes	No			
20	What level of understanding do you have about the possible estate taxes on your business?	none	low	some	high	excellent
21	How important do you feel succession planning is for your business?	very unimportant	unimportant	neutral	important	very important
22	Where is succession planning on your list of priorities?	not a priority	low priority	equal to other priorities	high priority	critical

Appendix B: Business Succession Survey Results

1. First, we will ask you some basic questions about your business. Please answer to the best of your ability. What industry is your business in?

#	Answer		Response	%
1	Agriculture, Forestry, Fishing and Hunting		0	0%
2	Mining, Quarrying, and Oil and Gas Extraction		0	0%
3	Utilities		0	0%
4	Construction		1	5%
5	Food Manufacturing		1	5%
6	Manufacturing		10	53%
7	Wholesale Trade		0	0%
8	Retail Trade		0	0%
9	Transportation and Warehousing		1	5%
10	Information		0	0%
11	Finance, Insurance and Real Estate		0	0%
12	Professional, Scientific, and Technical Services		1	5%
13	Management of Companies and Enterprises		0	0%
14	Educational Services		0	0%
15	Health Care and Social Assistance		1	5%
16	Arts, Entertainment, and Recreation		0	0%
17	Accommodation and Food Services		0	0%
18	Other Services (except Public Administration)		4	21%
	Total		19	100%

Statistic	
Mean	9.32
Variance	27.67
Standard Deviation	5.26
Total Responses	19

2. How many years has your business been in operation?

Text Response
24
26
13
6 years
30 years
60
38
23
1
11
6
Since 1983
12 years
79
1 year
6.5
6 years
16
63

Statistic	
Total Responses	19

3. How many employees does your business have?

Text Response
30
100
45
55
58
9
20
2
3
50

33
2
41 employees
13
44
50
55
15
55

Statistic	
Total Responses	19

4. What was your business' total revenue (in $) this last fiscal year?

Text Response
2,500,000
3mm
16,000,000+
5 million
$15,500,000
1,000,000.00
2,000,000
$ 4MM
0
5,600,000
5.8 million
N/A
$1,200,000
$5000000
5 million
$13 million

Statistic	
Total Responses	16

5. How long has the present owner(s) owned the business?

Text Response
24 yrs
1 year
13 years
6 years
30 years
60 YEARS
Current 2 owners; 1 owner for 22 years, 2nd owner for 2 years
23
1 yr
11
present owners are founders
Since 1983
12 years
1 year
6.5
6 years
33 years

Statistic	
Total Responses	17

6. What stage do you believe your business is in currently?

#	Answer		Response	%
1	Startup		0	0%
2	Growth		14	78%
3	Maturity		4	22%
4	Decline		0	0%
	Total		18	100%

Statistic	
Mean	2.22
Variance	0.18
Standard Deviation	0.43
Total Responses	18

7. How often do you conduct company valuations (determining the total value of your company at a given time)?

#	Answer		Response	%
1	Never		6	33%
2	Every 10+ Years		3	17%
3	Every 5-10 Years		3	17%
4	Every 3-5 Years		2	11%
5	Every 1-3 Years		4	22%
	Total		18	100%

Statistic	
Mean	2.72
Variance	2.57
Standard Deviation	1.60
Total Responses	18

8. Now we will ask some questions about you, the business owner. How old is the business owner?

#	Answer		Response	%
1	under 35		1	6%
2	35-45		2	11%
3	45-55		9	50%
4	55-65		4	22%
5	65+		2	11%
	Total		18	100%

Statistic	
Mean	3.22
Variance	1.01
Standard Deviation	1.00
Total Responses	18

9. How many years until the primary owner(s) plan to retire?

#	Answer		Response	%

1	20+ years		1	6%
2	15-20 years		3	17%
3	10-15 years		6	33%
4	5-10 years		6	33%
5	Less than 5 years		2	11%
	Total		18	100%

Statistic	
Mean	3.28
Variance	1.15
Standard Deviation	1.07
Total Responses	18

10. Is the business owner the primary or most important asset to the business?

#	Answer		Response	%
1	Yes		12	67%
2	No		6	33%
	Total		18	100%

Statistic	
Mean	1.33
Variance	0.24
Standard Deviation	0.49
Total Responses	18

11. Have you planned for the unexpected incapacitation/death of the primary owner/s?

#	Answer		Response	%
1	Yes		10	56%
2	No		8	44%
	Total		18	100%

Statistic	
Mean	1.44

Variance	0.26
Standard Deviation	0.51
Total Responses	18

12. Now we will ask some questions about your future business plans and goals What is your current exit plan for the business?

#	Answer		Response	%
1	Sell to another company		6	33%
2	Management Buyout		0	0%
3	Transition to Next Generation		11	61%
4	Sell to Employees		1	6%
5	Sell Assets and Close Business		0	0%
	Total		18	100%

Statistic	
Mean	2.39
Variance	1.08
Standard Deviation	1.04
Total Responses	18

13. Have you shared retirement/ownership transition plans with:

#	Answer		Response	%
1	Senior Management		4	24%
2	Non-managing but inheriting family members		3	18%
3	Managing family members		9	53%
4	All Employees		1	6%
	Total		17	100%

Statistic	
Mean	2.41
Variance	0.88
Standard Deviation	0.94
Total Responses	17

14. If you plan to sell to management, transition to the next generation, or sell to employees, have you identified a potential successor?

#	Answer		Response	%
1	Yes		11	69%
2	No		5	31%
	Total		16	100%

Statistic	
Mean	1.31
Variance	0.23
Standard Deviation	0.48
Total Responses	16

15. Is there a system in place to train and develop potential successors?

#	Answer		Response	%
1	Yes		10	56%
2	No		8	44%
	Total		18	100%

Statistic	
Mean	1.44
Variance	0.26
Standard Deviation	0.51
Total Responses	18

16. Do you feel the next generation of management has the same commitment to the business that the current owner does?

#	Answer		Response	%
1	Yes		11	65%
2	No		6	35%
	Total		17	100%

Statistic	
Mean	1.35

Variance	0.24
Standard Deviation	0.49
Total Responses	17

17. Have you developed a formal succession plan?

#	Answer		Response	%
1	Yes		2	11%
2	No		16	89%
	Total		18	100%

Statistic	
Mean	1.89
Variance	0.10
Standard Deviation	0.32
Total Responses	18

18. If so, how often do you review it?

#	Answer		Response	%
1	Never		5	71%
2	Every 5+ years		1	14%
3	Every 2-5 years		0	0%
4	Every 1-2 years		1	14%
5	More than once a year		0	0%
	Total		7	100%

Statistic	
Mean	1.57
Variance	1.29
Standard Deviation	1.13
Total Responses	7

19. Have you developed an estate plan?

#	Answer		Response	%

1	Yes		14	78%
2	No		4	22%
	Total		18	100%

Statistic	
Mean	1.22
Variance	0.18
Standard Deviation	0.43
Total Responses	18

20. What level of understanding do you have about the effect of estate taxes on the business?

#	Answer		Response	%
1	None		1	6%
2	Low		1	6%
3	Some		11	61%
4	High		5	28%
5	Excellent		0	0%
	Total		18	100%

Statistic	
Mean	3.11
Variance	0.58
Standard Deviation	0.76
Total Responses	18

21. How important do you feel succession planning is for the business?

#	Answer		Response	%
1	Very Unimportant		4	22%
2	Unimportant		0	0%
3	Neutral		3	17%
4	Important		6	33%
5	Very Important		5	28%
	Total		18	100%

Statistic	
Mean	3.44
Variance	2.26
Standard Deviation	1.50
Total Responses	18

22. Where is succession planning on your current list of priorities?

#	Answer		Response	%
1	Not a priority		1	6%
2	Low priority		6	33%
3	Equal to other priorities		9	50%
4	High Priorities		1	6%
5	Critical		1	6%
	Total		18	100%

Statistic	
Mean	2.72
Variance	0.80
Standard Deviation	0.89
Total Responses	18

Appendix C: Further Limitations

Fax limitations: I was not able to fax a complete paper version of the survey to these potential respondents, as there was no way for the fax to be sent back to me. The additional complexity involved in typing in the internet survey link, as well as the potential for the fax to not reach its intended recipient, the business owner, may have limited the potential respondent pool. In order to make the process of answering the survey as simple as possible, the full scale survey should make every attempt to identify and utilize the e-mail addresses of firm owners. In the event that this address cannot be identified, the survey should be e-mailed to a general e-mail address and a full paper survey should be faxed to the firm. Ideally, potential respondents who receive the survey by fax should have a toll-free number where they can fax the survey back. This will maximize the number of potential respondents, although business names will need to be collected to ensure that firms who answer the survey by both e-mail and fax are not counted twice.

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